

Message Text

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INFO OCT-01 EA-12 IO-14 ISO-00 SP-02 USIA-15 AID-05
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FRB-01 INR-10 NSAE-00 XMB-04 OPIC-06 LAB-04
SIL-01 DODE-00 PM-05 H-02 L-03 PA-02 /136 W
-----077382 011852Z /70

P R 011817Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 3690
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
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USEEC ALSO FOR EMBASSY
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DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
T AGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD FEB. 23 -MAR.

SUMMARY: STERLING STAYED ON THE SIDELINES WHILE THE DOL
LAR OCCUPIED CENTER STAGE IN A SOMETIMES HECTIC FOREIGN
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EXCHANGE MARKET. THE NATIONAL INSTITUTE (NIESR) FORE-
CAST 2.7 PERCENT REAL GROWTH IN 1978. THERE WAS NO
CHANGE IN FOURTH QUARTER FIXED CAPITAL INVESTMENT IN MAN-
UFACTURING BUT INVENTORY INVESTMENT WAS NEGATIVE. THE
CHANCELLOR OF THE EXCHEQUER EXPRESSED CONCERN ABOUT
THE POSSIBLE FAILURE OF INDUSTRIAL NATIONS TO TAKE AD-
DITIONAL MEASURES INDISPENSABLE TO PROMOTE MORE SATIS-

FACTORY GROWTH RATES.

UK FINANCIAL MARKETS WERE CALM.

END SUMMARY.

1. NIESR FORECAST. THE NATIONAL INSTITUTE FOR ECONOMIC AND SOCIAL RESEARCH (NIESR) CALLS FOR A MORE "RATIONAL" IN COMES POLICY MECHANISM AND A SUBSTANTIALLY SMALLER RISE IN AVERAGE EARNINGS IN THE NEXT PAY ROUND. NIESR CONTINUES TO URGE RESISTANCE TO ANY UPWARD PRESSURE ON STERLING. THE SHARPEST BARBS IN NIESR'S FIRST QUARTERLY ECONOMIC REVIEW FOR 1978 ARE RESERVED FOR ADVOCATES OF MONETARY TARGETRY AS THE MOST APPROPRIATE VEHICLE FOR MONETARY POLICY. NIESR'S FORECASTS FOR 1978 AND 1979 ARE FOR YEAR-ON-YEAR REAL GROWTH OF 2.7 AND 2.5 PERCENT, RESPECTIVELY, A CURRENT ACCOUNT SURPLUS IN EACH YEAR OF 1.3 BILLION POUNDS, AND HIGH SINGLE DIGIT INFLATION OVER THE PERIOD. (FURTHER DETAILS IN SEPTTEL.)

2. HEALEY SPEECH ON WORLD ECONOMIC SITUATION. CHANCELLOR OF THE EXCHEQUER DENIS HEALEY WARNED OF SERIOUS CONSEQUENCES OF A FAILURE TO CORRECT THE CURRENT WEAKNESSES AFFECTING THE INTERNATIONAL ECONOMY. IN AN ADDRESS TO A GATHERING OF DIPLOMATIC AND COMMONWEALTH WRITERS, MR. HEALEY SUMMARIZED THE CONFLICTING VIEWS OF COUNTRIES WHICH BELIEVED THAT CURRENT GROWTH RATES WERE TOO LOW AND

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TOGETHER WITH THE IMF AND THE OECD, WERE CALLING FOR ADDITIONAL STIMULUS AND THOSE COUNTRIES WHICH BELIEVED THAT EXCHANGE RATE STABILITY HAD TO BE ACHIEVED BEFORE THE PROBLEM OF SLOW GROWTH COULD BE TACKLED. ACCORDING TO PRESS REPORTS, THE CHANCELLOR SPOKE OF THE DEVELOPMENT OF "A POWERFUL DESIRE TO BREAK THE DEADLOCK BY ACTING ON ALL THE MAJOR PROBLEMS SIMULTANEOUSLY." MR. HEALEY SAID THAT WITHOUT EARLY ADDITIONAL MEASURES, THERE WAS NO CHANCE OF MEETING THE EEC'S 4-4.5 PERCENT REAL GROWTH TARGET FOR 1978.

3. MANUFACTURING AND INVENTORY INVESTMENT - 4TH QUARTER. THERE WAS NO INCREASE IN MANUFACTURING INVESTMENT IN THE 4TH QUARTER. ACCORDING TO PROVISIONAL ESTIMATES, FIXED INVESTMENT IN MANUFACTURING WAS UNCHANGED AT 454 MILLION POUNDS (1970 PRICES) IN THE 4TH QUARTER OF 1977. THE FOLLOWING TABLE SETS OUT THE LATEST QUARTERLY FIGURES:

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P R 011817Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 3691
TREASURY DEPT WASHDC PRIORITY
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	1970 PRICES (POUNDS MILLIONS) PERCENT CHANGE FROM 12 MONTHS EARLIER
1977 - I	420 3.7
II	432 6.1
III	454 7.8
IV (PROV.)	454 6.6
1977 - FULL YEAR (PROV.)	440 6.2

THE FOURTH QUARTER FIGURES DISAPPOINTED THOSE EXPECT-
ING MANUFACTURING INVESTMENT TO SHOW GREATER STRENGTH.
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AN IMPORTANT NEGATIVE INFLUENCE WAS THE SHARPLY REDUCED
LEVEL OF INVESTMENT BY THE BRITISH STEEL CORPORATION DUR-

ING THE SECOND HALF OF 1977. WHEN THIS FACTOR IS ELIMINATED, IT IS ESTIMATED THAT PRIVATE SECTOR INVESTMENT IN MANUFACTURING ROSE BY 12 TO 13 PERCENT IN 1977.

INVESTMENT IN INVENTORIES CONTINUED TO BE NEGATIVE IN THE FOURTH QUARTER AS PRODUCERS RAN DOWN STOCKS FROM THE HIGH LEVELS OF THE FIRST HALF OF 1977. THE FOLLOWING TABLE SUMMARIZES THE LATEST QUARTERLY INVENTORY INVESTMENT DATA:

1970 PRICES (POUNDS MILLIONS)	
1977 -- I	278
II	199
III	- 70
IV (PROV.)	- 45
1977 FULL YEAR --	361

THE PROVISIONAL 1977 TOTAL INCREASE IN INVENTORIES OF 361 MILLION POUNDS REPRESENTS A RISE OF ABOUT 0.8 PERCENT OF GDP COMPARED WITH A NEGLIGIBLE RISE (37 MILLION POUNDS) IN 1976. GIVEN THE DECLINES IN PUBLIC AND PRIVATE SECTOR DEMAND IN 1977, THE INVENTORY BUILDUP WAS LARGELY INVOLUNTARY. WITH STOCK/OUTPUT RATIOS STILL HIGH, IT SEEMS PROBABLE THAT THE INVENTORY CORRECTION WILL CONTINUE INTO THE FIRST QUARTER OF 1978.

5. FOREIGN EXCHANGE DEVELOPMENTS. THE DOLLAR HAS HAD A PROGRESSIVELY BAD WEEK SINKING TO NEW LOWS ON WEDNESDAY IN A HIGHLY ERRATIC AND FAIRLY ACTIVE MARKET. MOST OF THE ACTION HAS BEEN AGAINST THE DM, SWISS FRANC, GUILDER AND BELGIAN FRANC. STERLING HAS BEEN ON THE SIDELINES "MOVING BUT PONDEROUSLY." THIS SAID, IT HAS MOVED IN A FAIRLY WIDE RANGE, FROM \$1.9350 TO OVER \$1.95 AT TIMES.

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THE MAJOR EVENT OF THE WEEK HAS BEEN IMPOSITION BY THE SWISS OF CONTROLS AGAINST CAPITAL INFLOWS. THE MARKET SEES THIS AS PASSING THE PROBLEM ON TO THE GERMANS WHO ARE EXPECTED TO BE FORCED IN TURN TO TAKE SOME MEASURES AGAINST INFLOWS. THIS IS SEEN -- IF IT HAPPENS -- AS A SHORT-TERM EXPEDIENT WHICH WOULD CHANNEL THE UPWARD PRESSURE DIRECTLY ON THE YEN. MARKET COMMENTATORS ASK "WHAT THEN"? LOOKING IMMEDIATELY AHEAD, BASED ON MARKET COMMENTS, THE OUTLOOK IS ONE OF UNCERTAINTY.

LONGER TERM, TRADERS STATE THAT THE U.S. "NEEDS TO DO SOMETHING." THERE ARE RUMORS HERE OF THE IMPOSITION BY THE U.S. OF CAPITAL CONTROLS OVER OUTFLOWS INCLUDING CHANGES IN FED REGULATIONS Q AND M AND IMPOSITION OF AN INTEREST EQUALIZATION TAX TO DIVORCE THE DOMESTIC U.S. CAPITAL MARKET FROM THE EUROCURRENCY MARKET. SOME BANKERS CLAIM IT WAS THE EXPECTATION OF MOVES ALONG THIS LINE THAT LED TO HEAVY U.S. FINANCIAL OUTFLOWS IN RECENT

MONTHS. DEALERS CLAIM THAT PASSAGE OF A VIABLE ENERGY BILL IS ESSENTIAL IF THERE IS TO BE A TURNABOUT IN THE FORTUNES OF THE DOLLAR. ONE DEALER COMMENTING WISTFULLY SAID "HAPPINESS AND STABILITY IS A STRONG DOLLAR."

6. DOMESTIC FINANCIAL MARKETS WERE REASONABLY QUIET IN THE FACE OF THE CONSIDERABLE ACTIVITY IN THE FOREIGN EXCHANGE MARKET. LARGE PAYMENTS TO THE EXCHEQUER CREATED A SEVERE LIQUIDITY SHORTAGE FOR THE DISCOUNT HOUSES FEBRUARY 22, AND THE AUTHORITIES PURCHASED OVER 200 MILLION POUNDS OF TREASURY BILLS TO RELIEVE THE SHORTAGE. TODAY THERE WERE FEARS THAT THE AUTHORITIES WOULD FORCE THE DISCOUNT HOUSES TO BORROW FOR AN EXTENDED PERIOD AS SIGN DISAPPROVING OF A CHANGE IN MLR. LATE IN THE AFTERNOON, HOWEVER, THE AUTHORITIES INDICATED THAT THEY WOULD CONTINUE TO DISCOUNT TREASURY BILLS INSTEAD.

A NEW SHORT GILT WAS ANNOUNCED FRIDAY. IT IS THE 8-3/4 PERCENT EXCHEQUER 1980, PRICED AT 96-1/2 POUNDS
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PER 100 POUNDS NOMINAL VALUE, YIELDING GROSS 9.664 PERCENT TO REDEMPTION. THE YIELD SEEMED WELL PLACED WITH RESPECT TO YIELDS ON COMPARABLE MATURITIES, AND MARKET SOURCES FEEL THAT IT WILL BE ATTRACTIVE TO INSTITUTIONS.

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P R 011817Z MAR 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 3692
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ALTHOUGH 800 MILLION POUNDS (NOMINAL VALUE) OF THE GILT WILL BE ISSUED, 200 MILLION POUNDS WILL BE RESERVED TO THE NATIONAL DEBT COMMISSIONERS, THE BALANCE BEING OFFERED FOR THE PUBLIC ON THE APPLICATION DAY THIS THURSDAY.

GILT PRICES EASED OVER THE WEEK. MARKET SOURCES SPECULATED, HOWEVER, THAT THE MARKET WAS BASICALLY FIRM AND INSTITUTIONAL LIQUIDITY MORE THAN ADEQUATE, GIVING A POTENTIAL BASE FOR INCREASED DEMAND. MARKET SOURCES ALSO INDICATED THAT THE GOVERNMENT BROKER MAY HAVE BEEN SMOOTHING THE SHORT END OF THE MARKET IN PREPARATION FOR UNCLASSIFIED

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THE THURSDAY APPLICATION.

7. EXCHANGE RATE AND GOLD EFFECTIVE

DATE	EXCHANGE RATE		GOLD (\$)
	EXCHANGE RATE (\$)	(DEC. 1971 EQUALS 100)	
2/22	1.9480	65.7	181-3/8
2/23	1.9530	65.7	183-1/8
2/24	1.9300	65.5	180-3/8
2/27	1.9320	65.3	181-3/8
2/28	1.9415	65.2	182-5/8

CHANGE 2/21-2/28 DOWN 0.0035 DOWN 0.5 UP 1-1/2

8. FORWARD PREMIUM ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
2/22	- 0.05	- 0.06	- 0.40
2/23	0.02	- 0.03	- 0.40
2/24	0.02	- 0.10	- 0.35
2/27	- 0.02	- 0.17	- 0.45
2/28	- 0.05	- 0.12	- 0.50

CHANGE 2/12-1/28 DOWN 0.10 DOWN 0.07 DOWN 0.15
 (ALL FIGURES IN CENTS)

9. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTH
2/22	6-5/8	7-1/4	7-3/4
2/23	7-1/8	7-3/8	7-7/8
2/24	7-3/8	7-3/8	7-3/4
2/27	7	7-3/8	7-3/4
2/28	7	7-1/2	7-5/8

CHANGE 2/21-2/28 UNCHANGED UP 1/8 DOWN 1/8

10. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST
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RATE DIFFERENTIAL

DATE	
2/22	- 1/4
2/23	- L5/32
2/24	- 17/32
2/27	- 17/32
2/28	- 17/32

CHANGE 2/21-2/28 DOWN 5/32

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11. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
2/22	7-29/32	6-7/8	7-17/32
2/23	6-7/32	6-45/64	7-5/16
2/24	6-1/4	6-11/16	7-3/8
2/27	6-7/16	6-3/4	7-1/2
2/28	6-7/16	6-3/4	7-1/2

CHANGE 2/21-2/28 UP 1/8 UP 5/32 UNCHANGED

12. INTERPOLATED REDEMPTION YIELDS OF HIGH COUPON GOVERN-
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MENT SECURITIES

DATE	5 YEARS	15 YEARS	25 YEARS
2/22	10.51	11.98	12.07
2/23	10.49	11.92	12.00
2/24	10.57	12.00	12.08
2/27	10.60	12.12	12.21
2/28	10.57	12.08	12.17

CHANGE 2/21-2/28 UP 0.08 UP 0.15 UP 0.15

13. THE MINIMUM LENDING RATE REMAINED 6-1/2 PERCENT AS TH
AVERAGE TREASURY BILL RATE ROSE BY 0.0025 PERCENT TO
5.9755 PERCENT AT FRIDAY'S AUCTION. THE 300 MILLION
POUNDS IN BILLS OFFERED ATTRACTED 598.83 MILLION POUNDS
IN BIDS. THIS WEEK 400 MILLION POUNDS IN BILLS WILL BE
OFFERED AS 500 MILLION POUNDS MATURE.

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